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15th August 2016

BG's Wake Up Call

INDRA SISTEMAS

NEUTRAL, Fair Value EUR11 (-5%)

Acquisition of Banco Popular's mortgage loan processing business

On Friday last week, Indra announced an exclusive agreement for the acquisition of the entity which runs Grupo Banco Popular's loan processing business, for an undisclosed sum. Adding 94 staff, the company doubles its mortgage loan BPO team. The deal, which is valid for 10 years, is assumed to be accretive to both EPS and free cash flow from 2016, given its high level of profitability. We estimate this acquisition is accretive by 2% to our adj. EPS ests. for 2016-18.

	Last close	Daily chg (%)	Chg YTD (%)
Indices			
Dow Jones	18576.47	-0.20%	+6.61%
S&P 500	2184.05	-0.08%	+6.85%
Nasdaq	5232.89	+0.09%	+4.50%
Nikkei	16869.56	-0.3%	-11.11%
Stoxx 600	346.087	-0.17%	-5.39%
CAC 40	4500.19	-0.08%	-2.95%
Oil /Gold			
Crude WTI	44.49	+2.30%	+19.60%
Gold (once)	1353.43	+0.06%	+27.40%
Currencies/Rates			
EUR/USD	1.1179	0.00	+2.91%
EUR/CHF	1.08805	+0.20%	+0.06%
German 10 years	-0.167	+9.00%	-126.39%
French 10 years	0.112	-7.64%	-88.60%
Euribor	-0.299	0.00	+128.24%

Upcoming BG events :

Date	Event
1st-Sept	L'OREAL (BG Paris roadshow with CFO)
8th-Sept	ACCOR (BG Roadshow with CFO)
13th-Sept	Thematic Breakfast with ARCEP
14th-Sept	SAINT GOBAIN (BG Luxembourg roadshow)
22nd-Sept	Thematic Lunch with HC specialist
30th-Sept	Thematic Breakfast with Vimpelcom

Recent reports :

Date	Report Title
26th-Jul	NICOX Don't turn a blind eye to opportunities
21st-Jul	SEMICONDUCTORS : Looking for lost growth
13th-Jul	Oncology is an increased focus
12th-Jul	DANONE No redemption
1st-Jul	UBISOFT Same player shoot again?
29th-Jun	ORANGE : Lights are turning green.

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TMT

Indra Sistemas

Price EUR11.61

Acquisition of Banco Popular's mortgage loan processing business

Fair Value EUR11 (-5%)

NEUTRAL

Bloomberg	IDR.SM
Reuters	IDR.MC
12-month High / Low (EUR)	11.7 / 7.7
Market Cap (EURm)	1,906
Ev (BG Estimates) (EURm)	2,599
Avg. 6m daily volume (000)	862.6
3y EPS CAGR	

On Friday last week, Indra announced an exclusive agreement for the acquisition of the entity which runs Grupo Banco Popular's loan processing business, for an undisclosed sum. Adding 94 staff, the company doubles its mortgage loan BPO team. The deal, which is valid for 10 years, is assumed to be accretive to both EPS and free cash flow from 2016, given its high level of profitability. We estimate this acquisition is accretive by 2% to our adj. EPS ests. for 2016-18.

ANALYSIS

	1 M	3 M	6 M	31/12/15
Absolute perf.	19.9%	17.8%	47.9%	33.9%
Softw. & Comp.	9.9%	10.6%	19.9%	4.7%
DJ Stoxx 600	2.9%	3.9%	10.8%	-5.4%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	2,850	2,722	2,794	2,900
% change		-4.5%	2.6%	3.8%
EBITDA	107	223	308	370
EBIT	-641.0	160.0	237.0	295.0
% change		NS	48.1%	24.5%
Net income	-73.0	87.0	150.0	192.0
% change		NS	72.4%	28.0%

	2015	2016e	2017e	2018e
Operating margin	1.6	5.9	8.5	10.2
Net margin	-22.5	3.1	5.3	6.5
ROE	-208.1	21.5	27.3	26.0
ROCE	-11.7	11.7	17.7	21.9
Gearing	227.0	178.0	96.0	41.0

(€)	2015	2016e	2017e	2018e
EPS	-0.40	0.48	0.82	1.06
% change		NS	70.8%	29.3%
P/E	NS	24.2x	14.2x	11.0x
FCF yield (%)	NM	0.8%	8.4%	10.5%
Dividends (€)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	0.9x	1.0x	0.9x	0.8x
EV/EBITDA	24.3x	11.7x	7.9x	6.0x
EV/EBIT	56.6x	16.2x	10.2x	7.5x

• **Rationale of the deal.** Indra has reached an exclusive agreement with Grupo Banco Popular for the complete management of its mortgage loan processing division for a 10-year period. This agreement will become effective on 31st October 2016, and involves the acquisition of the entity which runs this business. As such, 94 staff from Grupo Banco Popular will join Indra, which is doubling Indra's mortgage loan BPO team. The rationale of the deal for Banco Popular is to achieve segregation of duties on control and management functions for this business. At the same time, Indra increases its ability to offer proprietary technology solutions for the entire set of services across the mortgage loan business cycle, as well as improving its competitive position in international markets in this area.

• **EPS and free cash flow accretion from 2016.** According to Indra, the deal offers a high level of profitability and is expected to be EPS and free cash flow accretive from 2016 onwards. The management also expects Banco Popular's mortgage loan management business generates significant synergies that improve Indra's margins in the same business, which essentially stems from the acquisition of BMB Gestión Documental between 2005 and 2007 and was seriously affected by the plummeting in the number of mortgage loans awarded in Spain from 2008. Since then, with the Spanish economy recovering, we understand Indra is looking to benefit from higher transaction volumes and related BPO revenues.

• **Slightly increasing our forecasts.** If we assume that the acquired business generates c. EUR20m revenues per year and EBIT margin is around 20% (EBITDA margin: c. 45%), based on an acquisition price representing 6.5-7x EBITDA (i.e. c. EUR60-65m), we estimate EPS accretion to be 2% by 2017-18 including synergies with Indra's existing mortgage loan BPO business. We also estimate the deal increases free cash flow modestly, by c. EUR5-10m per year - the target set for 2018 is c. EUR200m and we estimate it for 2016 at EUR17m including non-recourse factoring. Finally, we estimate the acquired business will be accretive to our the non-IFRS operating margin by 0.1ppt and help Indra to achieve its goal of 10-11% for 2018 (BG est.: 10.2% vs. 10.1% previously).

• **No change to our investment case.** The share price rose by 34% year-to-date following a sharp net debt reduction in Q4 2015, profitability improvement in line with the trajectory announced in July 2015 for 2018, and Q2 2016 results above consensus. While management remains cautious for the rest of the year due to the current political environment in Spain and Latin America and free cash flow remains low, we consider Indra is paving the way for future growth with strong order intake and Brazil starting to turn around.

VALUATION

- Indra's shares are trading at est. 16.2x 2016 and 10.2x 2017 EV/EBIT multiples.
- Net debt on 30th June 2016 was EUR659.4m (net gearing: 199%).

NEXT CATALYSTS

Q3 2016 results in November.

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BG's Wake Up Call

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BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 55.7%

NEUTRAL ratings 33.6%

SELL ratings 10.7%

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